

Proposed Language With Notes For Regulation 25136

§ 25136. Sales Factor. Sales Other than Sales of Tangible Personal Property in this State.

- (a) In General. Sales other than those described under Revenue and Taxation Code Section 25135 are in this state if the taxpayer's market for the sales is in this state.
- (b) General definitions.
 - (1) "Purchaser" means the taxpayer's customer who received the benefit of the services.
 - (2) "Benefit of a service" means that a taxpayer has used a service and either directly or indirectly received value from the use of that service.¹
 - (3) "To the extent" means that if the purchaser of a service receives the benefit of a service or uses intangible property in more than one state, the gross receipts from the performance of the service or the sale of intangible property are included in the numerator of the sales factor according to the portion of the services received and/or the use of the intangible property in this state.²
 - (4) "Cannot be determined" means that the taxpayer's records do not indicate where the benefit of the service was received or where the intangible property was used. In computing the sales factor under RTC section 25136, the Franchise Tax Board shall consider the effort and expense required to obtain the necessary information. In appropriate cases, such as when the necessary data cannot be developed from financial records maintained in the regular course of business, the Franchise Tax Board may permit or require reasonable approximations which are consistent with the nature of the taxpayer's business.³
 - (A) Example. Small Corp, a corporation located in this state, provides limited bookkeeping services to clients both within and outside this state. Some clients have several operations among various states. For the past ten (10) years, Small Corp's only records for the sales of these services have consisted of invoices with the billing address for the client. Small Corp's records have been consistently maintained in a reasonable fashion

¹ This language is based on the definitions in the sales and use tax laws in the states of Massachusetts, New Jersey and Texas.

² This language is a result of comments received at and following the February 10, 2010 Interested Parties Meeting.

³ Following the February 10, 2010 Interested Parties Meeting (IPM), several commentators expressed a desire to see Ohio's provision that taxpayers not be required to incur unreasonable expense and alter their record-keeping systems in order to comply with the provisions of Section 25136. This provision as written is patterned after Regulation Section 25106.5-10(e)(1).

considering the limited nature of the business. If the FTB determines that it is an undue burden on Small Corp. to provide more accurate data as to the location of the benefit received from their services to a particular customer, then sales of services will be assigned to this state utilizing the billing address data maintained by the taxpayer. Small Corp will not be required to alter its record keeping for purposes of this regulation.

- (5) "Reasonably approximated" means that, considering all sources of information including publicly available information, the location of the market for the benefit of the services or the location of the use of the intangible property was determined in a manner that is consistent with the business of the customer.⁴
- (c) Sales from services are assigned to this state to the extent the purchaser of the service receives the benefit of the service in this state.
 - (1) "Received the benefit of the service in this state" means:
 - (A) In the case where an individual is the customer⁵:
 - 1. The determination of whether the benefit of the service is received in this state shall be made in the following manner:
 - A. If, under the terms of a contract between the taxpayer and the purchaser who purchased the services, the location where the benefit is received is determinable and is in this state, then the terms of the contract shall control.
 - B. If the location where the benefit of the service is delivered cannot be determined pursuant to paragraph 1A, then the billing address of the customer is presumed to be the location where the service is delivered for use. This presumption may be overcome by evidence showing that the service was not delivered to the billing address. If the presumption is overcome, then a reasonable approximation can be made under paragraph 1C.
 - C. If the location where the services are delivered for use cannot be determined under the terms of the contract, then the location of the services shall be reasonably approximated.

⁴ There was at least one comment at the February 10, 2010 IPM requesting that we address this issue. With the exception of the provision(s) regarding royalty or other similar payments, this language is not meant to "look-through" the taxpayer's customer to the taxpayer's customer's customer.

⁵ We felt that individuals should have different cascading rules from corporate or other business customers. There is an emphasis in the individual's provision that the individual's billing address will usually be where the services are delivered. The ordering location provision for corporate and other business customers would not normally apply to individuals.

2. Examples.

- A. Software Tech Support Corp located in this state provides technical support services to its customers, who are located throughout the United States, through a call center in this state. The typical customer telephones the call center to resolve an issue with software that they are using on their desktop. For billing purposes, Software Tech Support Corp gets credit card information from each customer over the phone. Software Tech Support Corp's records maintained in the regular course of business indicate that seven (7) percent of the calls handled by the call center originate from this state. Because Software Tech Support Corp's records maintained in the regular course of business show where the benefit of the services are actually received at a billing address in this state, seven (7) percent of the gross receipts from the support services provided by the call center are attributable to this state and included in this state's sales factor numerator.
- B. Cell Phone Corp has multiple individuals who are customers throughout the United States. In this state, Cell Phone Corp customers make and receive calls and have a billing address in this state. Gross receipts derived by Cell Phone Corp from a billing address in this state are included in the sales factor numerator of this state.
- C. TV Corp provides cable television and telecommunications services to individuals in this state and other states for a monthly fee billed to the customer's address. Gross receipts from these services are assigned to this state if the billing address of the customer is in this state.

(B) In the case where a corporation or other business entity is the customer:

- 1. The determination of whether the benefit of the service is received in this state shall be made in the following manner:
 - A. If, under the terms of a contract between the taxpayer and the purchaser who purchased the services, the location where the benefit is received is determinable and is in this state, then the terms of the contract shall control.
 - B. If the location where the service is delivered cannot be determined under the terms of the contract, then it shall be reasonably approximated;

- C. If the location where the benefit of the service is received cannot be determined subsections A and B, then the receipts from the service shall be determined as provided in paragraphs D and E.
- D. If the location where the benefit of the service is received cannot be determined under paragraph 1, then the location where the benefit of the service is received shall be deemed to be the location from which the customer placed the order for the service.
- E. If the location where the benefit of the service is received cannot be determined pursuant to paragraphs 1 or 2, then the benefit of the service shall be in this state if the customer's billing address is in this state.

2. Examples.

- A. Payroll Services Corp contracts with Customer to provide all payroll services. Customer is headquartered in this state and has employees in a number of other states. The contract between the taxpayer and the Customer does not specify where the service will be used by the Customer. Customer's payroll department in this state accesses the website of Payroll Services Corp to distribute payroll to all of its locations. All gross receipts from the payroll services provided to Customer are included in the sales factor numerator of this state.
- B. Law Corp located in State C has a corporate client that is headquartered in State A and has manufacturing plants in this state and State B. Law Corp handles a major litigation matter for the client concerning a manufacturing plant owned by its client in this state. Lawyers from Law Corp travel to this state for depositions and the lengthy trial is also conducted in this state. For purposes of this regulation, all gross receipts from Law Corp's services related to the litigation are attributable to this state, because the services relate to the client's operations in this state.
- C. Accounting Corp is hired by and gives tax advice to Car Corp. Car Corp does business throughout the United States. Accounting Corp gives tax advice to Car Corp for all states where Car Corp does business. For purposes of this regulation, the sales of Accounting Corp's services will be assigned to this state based on the service provided to Car Corp in this state as determined under the terms of the contract between Accounting Corp and Car Corp. If the terms of the contract do not break down the fees by state or otherwise determine the value of the services received in this state, then Accounting Corp's gross receipts can be reasonably approximated by using available public information

indicating the market of Car Corp in this state. Accounting Corp's sales will be assigned in proportion to Car Corp's market in this state as compared to Car Corp's market everywhere.

- D. Web Corp provides internet content to its subscribers and receives revenue from providing advertising services to other businesses. The advertisements are shown via the website to Web Corp subscribers and the fee collected is determined by reference to the number of times the advertisement is viewed and/or clicked on by viewers of the website. Web Corp shall reasonably approximate the location of the benefit of the receipt by assigning its gross receipts from advertising by a ratio of the number of its subscribers in this state to the number of its subscribers everywhere.
- (d) Sales from intangible property are assigned to this state to the extent the property is used in this state.
- (1) In the case of the complete transfer of all property rights in intangible property for a jurisdiction or jurisdictions, not including the use, licensing, lease, rental or other use of intangible property, including patents, copyrights, licenses, plans, specifications, blueprints, processes, techniques, formulas, designs, layouts, patterns, drawings, manuals, technical know-how, and contracts, the sales are properly assigned to this state if:⁶
 - (A) The intangible property is used by the purchaser at the time of purchase exclusively in this state;
 - (B) The intangible property is used by the purchaser at the time of purchase in this state and another state to the extent of the purchaser's location in this state as compared to the purchaser's locations everywhere;
 - (C) If the extent of the use of the intangible property cannot be determined pursuant to subsections (A) or (B), it shall be reasonably approximated;

⁶ We thought it would be appropriate to provide different rules for sales of intangible property from the rules for the use or licensing of intangible property. When a corporation makes a complete transfer of all its rights in the intangible property, that corporation may not be able to determine the ultimate market for that intangible property. However, when a corporation merely licenses its technology to a third party, the on-going relationship between the parties allows the licensing corporation the ability to know how that technology is used and the location of the ultimate customers. For instance, a payor might pay the licensor a fee based on a percentage of sales of the underlying tangible personal property. The payor would most likely want to know its market and for marketing purposes track sales by individual states. The contract between the payor and the licensor may have a provision that the licensor could request from the payor a state-by-state breakdown of product sales. This provision would serve several purposes: the licensor could verify the fee it should be receiving from the payor and calculate its California sales factor (other states have similar provisions which would also require a state-by-state breakdown.) Therefore, we developed rules for these type sales that would allow a look-through from the taxpayer's customer (e.g. the manufacturer) to the ultimate customer who buys the tangible personal property which is produced with the technology of the licensor.

- (D) If the extent of the use of the intangible property cannot be determined pursuant to subsections (A), (B), or (C), then the gross receipt shall be assigned to the billing address of the customer.⁷
 - (E) Example. Farm Auction Corp purchases Cattlemen Auction Corp's mobile workforce-in-place for this state, State A and State B for a flat fee. There are ten (10) auctions every year in this state. There are five (5) auctions every year in State A and in State B. Cattlemen Auction Corp's gross receipts in this state can be determined by multiplying the amount of the fee by the percentage this state's auctions represents as compared to all three (3) states' auctions which total twenty (20) auctions.⁸
- (2) The licensing, leasing, rental or other use of intangible property, including patents, copyrights, licenses, plans, specifications, blueprints, processes, techniques, formulas, designs, layouts, patterns, drawings, manuals, technical know-how, and contracts pursuant to a licensing, leasing, rental, or similar agreement, not including sales of intangible property provided for in subsection (1), are in this state:
- (A) To the extent the intangible property is used in this state by the taxpayer's customer as is provided for by the contract between the taxpayer and the taxpayer's customer;
 - (B) If the intangible property is used by the taxpayer's customer in this state and another state and the extent it is used in this state is not determinable pursuant to subsection (A), the extent of the use shall be measured by the volume of the tangible personal property which is sold by the taxpayer's customers at or from locations in this state and which gives rise to payments to the taxpayer;
 - (C) If the extent of the use of the intangible property in this state cannot be determined under subsections (A) or (B), it may be reasonably approximated; or
 - (D) If the extent of the use of the intangible property in this state cannot be determined pursuant to subsections (A), (B), or (C), then the gross receipts shall be assigned to the commercial domicile of the taxpayer's customer.
 - (E) Examples.

⁷ Comments at the February 10, 2010 Interested Parties Meeting seemed to indicate that cascading rules were desirable for the sale of intangible property. We did not include a provision for assignment to the location from which the intangible property was ordered because we felt that such a provision was not usually applicable to purchases of intangible property and would be awkward to apply.

⁸ A workforce-in-place is considered to be intangible property by the Internal Revenue Service.

1. R&D Corp and Manu Co enter into a licensing contract whereby Manu Co as licensee is permitted to use technology that is owned by R&D Corp in connection with Manu Co's manufacture and sale of products for sale in a specified geographic region. Under the contract, Manu Co is required to pay R&D Corp a licensing fee that is a fixed percentage of the total volume of monthly sales made by Manu Co of products manufactured using the R&D Corp technology. Manu Co sells the products throughout the United States. The contract between the two companies does not break down the sales per state but does provide that R&D Corp can ask for a sales breakdown from Manu Co. In order to assign the license fee R&D Corp should request the state by state breakdown of sales from Manu Co and assign the gross receipts derived from Manu Co's sales to customers in this state to the sales factor numerator for this state.
 2. Tech Development Corp developed for its customer specific technology for a computer game manufactured and sold by its customer Game Corp. Game Corp sells its games throughout the United States. The contract between the two companies does not break down the sales per state and does not provide that Tech Development Corp may ask for a sales breakdown from Game Corp. The component of the licensing fee that constitutes the gross receipts in this state of Tech Development Corp may be reasonably approximated by multiplying the amount of the fee by the percentage that the population in this state represents as compared to the total population of the United States.
- (e) Sales from the sale, lease, rental, or licensing of real property are in this state if the real property is located in this state.
- (f) Sales from the rental, lease, or licensing of tangible personal property are in this state if the tangible personal property is located in this state.
- (g) Special Rules.
- (1) Where the sales of services or sales of intangible property are between related parties, the following special rule applies⁹:
- (A) Receipts from intangible property, to the extent not eliminated from the sales factor pursuant to Regulation Section 25106.5-1, are in this state if the sale of services or intangible property is in this state pursuant to subsections (c) or (d) of this regulation.

⁹ We feel that special rules are necessary for related parties. Related parties have access to one another's information and as a result related parties should be able to obtain sales information from one another. This language is based on SB 1750 previously distributed at the February 10, 2010 IPM.

- (B) A taxpayer is presumed to have properly reported in this state any intercompany receipts if the taxpayer computes the amount of such receipts in this state by using a percentage, the numerator of which is the entire unitary group's total product and service sales receipts in this state related to total intercompany intangible property sales not eliminated from the sales factor and the denominator of which is the entire unitary group's total product sales and service sales receipts related to total intercompany intangible property sales not eliminated from the sales factor.